



Opportunities for Results-Based Financing at MCC

What is Results-Based Financing?

Results-Based Financing (RBF) encompasses a broad class of interventions referred to by terminology sometimes used interchangeably, including the World Bank's Program-for-Results (P4R) and the Center for Global Development's Cash-on-Delivery (COD) aid, among several others. In RBF, payments are made conditional on the achievement of certain predetermined outputs or targets. In this way, RBF aims to improve service delivery by incentivizing the achievement of desired results while providing flexibility in terms of the implementation modality. Results are generally measured in terms of outputs, such as number of children immunized, but RBF can in theory also be structured to focus on outcomes. The RBF approach contrasts to traditional "fee for service" models that focus on careful program design and paying for inputs rather than paying for outputs. According to the Urban Institute ¹, "Several theories have been postulated for why linking payments to results will yield better outcomes, including by appealing to recipients' pecuniary interests, drawing the attention of politicians and bureaucrats, generating accountability to constituents, and creating opportunities for parties to adapt and learn."

One of the primary ways in which RBF may improve outcomes is to create explicit incentives for performance. RBF is an example of an output-based incentive contract, a well-studied problem in economics, applied in the context of international development. In the basic theory of incentives contracts, the principal should transfer risks to the agent whenever the agent has manageable control over the realization of that risk. The agent, whether a service provider, a government agency or utility, internalizes the risk of non-achievement of results and therefore to seek solutions to avoid it. The principal – whether a government agency, donor, or other organization – may benefit from RBF because the scheme requires less local knowledge of the agent's political and managerial constraints, at least to the extent that the agent's incentives can be aligned with the goals of the principal.

However, evidence on the performance of RBF is still emerging and in some areas is mixed. One of the first evaluation frameworks to allow for the comparison of RBF to traditional financing approaches is currently being implemented by the United Kingdom's Department for International Development in the AgResults project. Evidence on RBF in the health sector is also mixed. ² A related literature on teacher pay-for-performance shows mixed results depending on context and implementation, with recent null results in a nationwide program in Peru. ³

An additional consideration when implementing a traditional input-based financing model versus RBF is

the cost of independent verification of outcomes. In the example of low emissions cultivation strategies, which is part of an AgResults project in Vietnam, behavior change may be particularly difficult to measure and verify. Open questions remain regarding RBF's implementability and impacts.

History & Taxonomy of RBF

Bilateral and Multilateral donor organizations have pursued the use of RBF for over a decade as a tool in their program design toolbox. To date, program funding has been limited in scope—focused on adding conditionality on the release of funding tranches—or applied within a limited sample of sectors, such as health. The P4R funding of the World Bank is perhaps the exception: it has grown significantly since its inception in 2012 and now covers over \$30 billion in more than 100 projects.

The Urban Institute ⁴ suggests an RBF taxonomy including the following approaches:

- **Development Impact Bonds:** Introduced in 2013 by Social Finance UK and the Center for Global Development, development impact bonds provide up-front funding from investors to a social service provider with the investor repaid only upon successful achievement of specific outcomes as measured by an independent evaluation.
- **Outcome-based aid/financing:** This mechanism conditions aid payments from donors to governments of developing countries on the achievement of specific outcomes.
- **Output-based aid/financing:** Output-based aid focuses on intermediate outputs and the achievement of certain targets in terms of the delivery of services.
- **Performance-linked payments:** An example of performance-linked payments is the World Bank's Program for Results, introduced in 2012. Performance-linked payments emphasize performance measurement, evaluation, and "behavioral and institutional changes required to achieve results and manage associated risks".
- **Conditional cash transfers:** Conditional cash transfers are implemented within social welfare or safety net schemes and condition the receipt of funds typically to households on achievement of certain actions, such as school enrollment.
- **Pay for success:** Pay for success encompasses investments that are funded by governments but shift risk typically to third-party investors, usually a private organization or nonprofit. If the investment is successful in achieving outcomes, funds are returned (potentially with an increment) to the original investors.

Box 1: Morocco II Compact

As part of a 5-year 450-million dollar Compact with Morocco, MCC is supporting the government in launching a new nationwide employment program in January 2020 targeted at women, long-term job seekers, and job seekers without formal qualifications. By tying funds to job placements and six-month labor market retention results, the program seeks to incentivize both national and international providers to design, deliver, and iterate on innovative training and intermediation interventions to achieve sustainable labor market outcomes for beneficiaries.

The Government of Morocco has been closely involved in the design of the program and has expressed a keen interest in scaling it up when the Compact ends in 2022. To facilitate the institutional adoption of

Box 1: Morocco II Compact

RBF, technical assistance will be provided to the Ministry of Employment and the Moroccan placement agency as part of the Compact.

The MCA is in the process of negotiating with 11 finalist organizations to be awarded grants to provide training and job placement services to up to 9,000 women and youth with up to 50% of the payments paid upon verification of pre-determined targets. The 16-month program will see a wide array of providers compensated on their ability to reach three key results: training completion, job placement, and six-month retention in the formal labor market. Placement and retention results will be verified through employer social security contributions, which are identifiable through the national health system's employer contributions database.

Results-Based Financing at MCC

In principle, RBF is well aligned with the MCC model due to its focus on accountability and results; however, various features of the MCC model may create challenges, including a rigid five-year implementation window and a required set of investment criteria. The latter includes MCC's 10% economic rate of return hard hurdle for every project and a requirement that the project must address a root cause of a binding constraint to economic growth. MCC continues to assess how to apply its investment criteria for the specific challenges presented by RBF programs.

MCC has piloted RBF in two programs (see Box 1 and 2) and is currently assessing the approach for several programs under development, including investments in Lesotho, Tunisia and Senegal. The experiences in Morocco and Sierra Leone have yet to be evaluated, and it is too early to draw lessons learned from these pilots.

Box 2. Sierra Leone Threshold Program

The \$44.4 million Sierra Leone Threshold Program includes a \$5 million Results-based Financing (RBF) activity as part of the Regulatory Strengthening Project.

By conditioning payment on results, this project aims to motivate improvements in planning, coordination, and operational and financial efficiency at the water and electricity utilities and the regulator.

The original design of the RBF mechanism included 27 individual key performance indicators for three separate utilities (providing water and electricity to Freetown) including, as a prerequisite for payment, a requirement for the utilities to report to the regulator. Several indicators also seek to walk the regulator through the steps needed to perform its regulatory responsibilities, such as, for example, conducting a utility reporting analysis.

Box 2. Sierra Leone Threshold Program

The RBF project was launched in June 2019 and will be implemented for one year alongside a learning agenda that seeks to identify drivers and inhibitors of the effectiveness and sustainability of the program.

Opportunities and challenges of RBF for MCC

RBF may be a creative instrument to help stakeholders find their own solutions. It can reduce the need for a detailed understanding of the internal political dynamics at our partner organizations. In one approach, MCC can use RBF mechanisms to fill gaps in program logics of larger programs, as in the case of Morocco (see Box 1). In another approach, MCC can use stand-alone RBF mechanisms to support policy or institutional reforms at partner organizations, as in Sierra Leone (Box 2). The flexibility afforded to our partners through RBF programs holds the promise of greater efficiency. However it may potentially come into conflict with MCC's environmental and social safeguards, for example, because not all perverse incentives can be anticipated and built into verification procedures *ex ante*.

There are also concerns around the use of RBF at MCC that are well-founded: (i) incentive contracts lack flexibility to respond to changing information and circumstances; (ii) effective indicators may be difficult to identify or may be difficult to measure; and (iii) if the agent is responsible for multiple tasks, the incentive mechanism can distort the agent's priorities by reducing the remuneration for competing tasks.

Furthermore, there may be a mismatch between the incentives of the organization and the agent that MCC wishes to target with the incentive. Organizations in poor developing countries may not have the capacity or resources to implement a change in internal management practices that would make the achievement of the output target possible and sustainable. Moreover, it may be difficult for the implementing entities in developing countries to bear the risk associated with a RBF scheme. MCC has dealt with these challenges by providing technical support and "pre-financing", i.e., funding to purchase equipment and other necessities not tied to targets.

Nevertheless,

Questions for EAC Discussion

MCC seeks evidence to help it shape guidance on RBF program design and cost-benefit analysis to make the best use of Results-Based Financing as a tool to achieve broader programmatic goals:

1. What types of RBF instruments are appropriate for MCC's mission? What are the limitations associated with different modalities within the MCC context?
2. Can MCC shape RBF interventions to better address MCC's investment criteria? If so, how? Specifically:

- a. How can RBF interventions be designed to meet MCC's 10% ERR 'hurdle rate'? Does RBF require a tolerance for greater uncertainty over outcomes?
 - b. Can RBF interventions be designed to address sustainability concerns regarding sustained impact and durability of benefits? Are there design features in RBF to support this?
 - c. Can the design and implementation of RBF programs fit into MCC's statutory 5 year implementation timeline?
3. How might MCC target RBF instruments to support agency objectives?
- a. Are there policy and institutional reform interventions (public financial management reform, regulatory strengthening, civil service reform, etc.) that are sufficiently measureable and verifiable to make RBF a feasible instrument of support?
 - b. How could MCC best use RBF instruments to better leverage *private sector* financing?
 - c. How can MCC avoid or mitigate the possibility of perverse incentives?

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Endnotes

1. Eldridge, M, and R. TeKolste. "Results-Based Financing Approaches." *Washington DC: Urban Institute*, 2016.
2. See, for example, Paul E., Albert L., Bisala BN'S., et al. "Performance-based financing in low income and middle-income countries: isn't it time for a rethink?" *BMJ Global Health* 2018.
3. Leaver, C., O. Ozier, P. Serneels, and A. Zeitlin. "Recruitment, effort, and retention effects of performance contracts for civil servants: Experimental evidence from Rwandan primary schools." *Mimeo*, 2019.
4. Eldridge, M, and R. TeKolste (2016).